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In the Supreme Court of the United States

OCTOBER TERM, 1958

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, AND THE EQUITY ANNUITY LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Securities and Exchange Commission, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered May 22, 1958, which affirmed the judgment entered on September 30, 1957 by the United States District Court for the District of Columbia.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, *infra*, pp. 21–30) is not yet reported. The opinion of the District Court (R. 82) is reported at 155 F. Supp. 521.

JURISDICTION

The judgment of the Court of Appeals was entered on May 22, 1958 (App. A, *infra*, pp. 30–31). The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1) which is made applicable by Section 22 (a) of the Securities Act of 1933 (15 U. S. C. 77v (a)) and Section 44 of the Investment Company Act of 1940 (15 U. S. C. 80a–43).

QUESTION PRESENTED

Whether a company which sells to the public its "deferred variable annuity policies," under which the purchaser receives an interest representing pro rata shares in the company's portfolio of securities and in the gains and losses therefrom, is required (a) to register those contracts pursuant to the Securities Act of 1933 and (b) to register as an investment company pursuant to the Investment Company Act of 1940; or whether exemptions in these Acts relating to annuities and to companies engaged in the business of writing insurance are available to the company.

STATUTES INVOLVED

The relevant statutory provisions of the Securities Act of 1933 (15 U. S. C. 77a), the Investment Company Act of 1940 (15 U. S. C. 80a), and the McCarran-Ferguson Insurance Regulation Act (15 U. S. C. 1011) are set forth in Appendix B, *infra*, pp. 32–37.

STATEMENT

This action was instituted by the Securities and Exchange Commission to enjoin the Variable Annuity

Life Insurance Company of America ("VALIC") from (a) offering and selling securities in violation of the registration requirements of Section 5 of the Securities Act of 1933 (15 U. S. C. 77e) and from (b) engaging in enumerated activities set forth in Section 7 of the Investment Company Act of 1940 (15 U. S. C. 80a–7), until registered as an investment company under Section 8 of that Act (15 U. S. C. 80a–8). The Equity Annuity Life Insurance Company ("EALIC") and the National Association of Securities Dealers, Inc. were granted leave to intervene as party defendant and party plaintiff, respectively.[1]

The respondents have been offering and selling what they describe as "Variable Annuities". They are chartered as insurance companies by the District of Columbia Department of Insurance and the particular contracts have been approved for sale as annuity contracts. The Securities and Exchange Commission contends that the interests are investment contracts, nonexempt securities. It was on this premise that the Commission instituted injunction proceedings.

Of several different types of contracts offered by respondents, the one which has been used by the lower courts as illustrative of the pertinent characteristics of these contracts is the "Deferred Variable Annuity." Under the terms of that contract, the purchaser, referred to in the contract as the "policy holder," promises to pay to the company a fixed sum of money, usually at specified periodic intervals, which the com-

[1] A petition for certiorari has been filed by the National Association of Securities Dealers, Inc., No. 237, this Term.

pany promises to pool with monies received from other purchasers and to invest in a portfolio of common stocks after having made certain specified deductions.[2] This portfolio is administered by respondents and common stocks are bought and sold in accordance with the investment judgment of their managements.[3] As payments are made, securities are acquired for the portfolio. In return for the money invested, the purchaser is credited with a certain number of "accumulation units." These units represent the purchaser's "aliquot" or undivided interest in the portfolio of securities purchased with his money (see Finding of Fact 45, R. 107), and therefore his interest fluctuates in direct relation to the value of the securities portfolio. During the period the purchaser makes payments the contract provides that he may at any time make prepayments, thus acquiring units at a more rapid rate than is provided in the contract. Or he may liquidate and withdraw all or a portion of his units.[4] In that event he receives a sum equal to

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[2] The loading charges per year are:
1st year, 52% of the amount invested.
2nd through 5th year, 12% of the amount invested.
6th through 10th year, 11% of the amount invested.
11th and thereafter, 8% of the amount invested.
In addition, the contract provides for a company management fee of 1.8% per annum on investments.

[3] Sales literature of EALIC, for example, states: "You avoid buying stocks on a 'hot tip.' Instead you benefit from the counsel of expert financial advisers; the Company purchases stocks upon the recommendation of The First National City Bank of New York. In short, you get the benefit of expert diversification." (Pl. Ex. 17.)

[4] By prepurchasing or by partially withdrawing units the purchaser may speculate upon the short term fortunes of the

the then value of the proportionate share of the fund's assets represented by the units redeemed. If he withdraws all of his units during the first five years of the contract, the company charges a penalty (see Findings of Fact 47, and 50, R. 107, 108).

After the maturity date, a date which has been preselected by the investor, presumably as the date on which he intends to retire, the purchaser is entitled to receive a series of monthly payments of fluctuating sums representing the then value of a fixed number of annuity units, which, like the accumulation units, represent an "aliquot" share of the portfolio of the securities of the fund (see Finding of Fact 70, R. 109). The number of "annuity units" comprising the monthly payment received by the purchaser is derived from the dollar value of the "accumulation units" at the maturity date, *i. e.*, the dollar value of the first monthly payment is calculated by reference to an annuity table and this is translated into the number of "annuity units." These payments continue

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company's portfolio. If he purchases units in advance, he gains if they increase in value before the time when he would have normally purchased them under the contract. If he withdraws part of his units, he gains if the units decrease in value at the time he repurchases them.

The purchaser may make a partial withdrawal of his units by getting what is termed a "policy loan." In this transaction, he "borrows" from the company the value of a number of units and the number of units credited to him is reduced by that number. When he repays the "loan," units are replaced at their then current value. Thus he may replace more or less units than he borrowed when he repays the money, depending on the interim fluctuations in the value of the portfolio.

for the rest of the purchasers life,[5] and during this period he may no longer exercise the withdrawal privilege.

The purchaser's interest thus fluctuates at all times in direct relationship to the changes in the market value of the portfolio securities and other assets of the fund (see Finding of Fact 46, R. 107). Prior to the maturity date, the value of the purchaser's interest reflects solely his investments, any income applicable thereto, and any profit or loss thereon. After the maturity date, the amount of the company's monthly payments to the purchaser continues to reflect all of these factors. At no time is any portion of the purchaser's risk of profit or loss borne by the company (Finding of Fact 49, R. 108).

The District Court denied the injunction, holding that, although "the logic of the law seems to bring the variable annuity contract within the purpose and intendment of the Securities Act, and the defendants within the terms and plan of the Investment Company Act," federal regulation is precluded by the McCarran-Ferguson Act (R. 89). The District Court indicated that that Act was applicable because the respondents had been "chartered as insurance companies by the District of Columbia and their questioned contracts had been approved by the Insurance Superintendent of the District, and by the insurance

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[5] After the institution of the Commission's action against VALIC, it ceased offering contracts providing an option for payment over a fixed term of years with no mortality feature (Pl. Ex. 6-A-1, P. 3). However, investors who had entered into those arrangements are continuing to purchase accumulation units thereunder.

departments of certain states" (R. 90). The court said that if the respondents had not been

> chartered, licensed and regulated by the District and state authorities and if Congress had not passed the McCarran Act, the questions raised by SEC would be answered by applying the rules of statutory construction to the Securities Act of 1933 and the Investment Company Act of 1940, and, in the opinion of this court, such construction would bring the defendants within the purview and purposes of those statutes. [R. 90.]

The Court of Appeals affirmed the holding of the District Court, but, in contrast to the ground for decision adopted in that court, it ruled that the contracts are within the exemptions provided by the securities laws for insurance. It stated that "The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance."

REASONS FOR GRANTING THE WRIT

1. The variable annuity is a novel type of contract which attempts to meet an important economic problem—*i. e.*, how an individual may by regular investment create a fund to provide adequately for his years of retirement in the face of a possible rise in the cost of living. If, as claimed by its proponents, it meets this need, it is likely that it will have a widespread acceptance among public investors. The Securities and Exchange Commission has no desire to prevent economic experimentation of this sort; in fact, much of the activity regulated by the Commis-

sion has traditionally been aimed at meeting various problems of inflation. The Commission is concerned, however, that under the decision below persons investing in variable annuities will be deprived of protections generally accorded investors by the Securities Act of 1933 and the Investment Company Act of 1940. These protections include full disclosure of all relevant information concerning securities registered with the Commission under the Securities Act, and regulation of various activities of the issuer flowing from registration under the Investment Company Act, including in this latter connection requirements as to definitive recitals of investment policy, the prohibition against changing such policy without approval of investors, and restrictions upon dealings between a company and its insiders.

It is the Commission's position that the activity involved under the variable annuity contract—*i. e.*, the placing of capital with a company for investment in common stock with a view to profit solely from the company's management of the investor's money, the pooling of the capital of many investors by the company, and the acceptance by the investors of all risks of market fluctuations—was intended to be regulated by the Congress under the federal securities laws.

Both opinions below recognize that the variable annuity provides an opportunity for an investor to increase his capital by investing it with the expectation that the efforts of the management will result in profit to the investor. This profit-seeking feature pervades all aspects of the contract because its claimed economic function of protecting against inflation by

an annuity cannot be realized without these profits. And it is this opportunity for profit resulting from the efforts of others which dictates the conclusion that the contract involved is a non-exempt security under the Securities Act, for the courts have repeatedly brushed aside the formal trappings of an instrument to hold that a contract involving investment risk is a security no matter how the issuer attempts to disguise it. This Court, for example, has twice ruled that a contract, the basic purpose of which is investment, is a security regardless of the form it takes. *S. E. C.* v. *W. J. Howey Co.*, 328 U. S. 293, and *S. E. C.* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344.

Respondents' contracts and operations are in most respects similar to those of the usual mutual fund or open-end investment company registered with the Commission under the Investment Company Act of 1940. These companies sell a substantial portion of their shares under periodic accumulation arrangements,[6] which are essentially identical to the variable annuity during the most extensive period of the variable annuity contract, the accumulation period prior to maturity. The shares sold under these periodic accumulation plans, like the variable annuity contracts, represent an aliquot interest in a portfolio of securities, usually equity securities. As with the variable annuity, the periodic accumulation plans provide that the investors pay a specified sum of money

[6] While exact information is not available, the dollar amount has been estimated at approximately $1,028,000,000 at June 30, 1958. *Statistical Bulletin*, National Association of Investment Companies, June 30, 1958.

at periodic intervals. In the variable annuity and in the investment company plans, this money, after certain specified deductions are made, is invested in securities to be added to the company's portfolio. Under the periodic accumulation plans, in return for the money invested, the investor is credited with a number of shares in a manner like that followed by respondents.[7] At any time during the life of a periodic plan, moreover, the investor may stop buying shares, may partially liquidate his shares, may totally liquidate his holdings, or may purchase shares at a date prior to the time called for in the contract. These opportunities are the same as those available to the variable annuity purchaser during the pay-in period.

Although the respondents' contracts use insurance parlance, the basic economic factors differ substantially from those relating to insurance companies. An insurance company has to meet fixed obligations and, in the case of a stock company, will be insolvent if its investment policy is such that the insurance obligations cannot be met. Therefore, there is great economic pressure to invest conservatively. Respondents, however, are under no such pressure, since payment on variable annuities is made without reference to fixed dollar obligations. It is true that increased sales with resulting profits to the company would result from successful operation, but the chance

[7] As in the variable annuity, the investor usually receives only a notification of how many shares he owns but does not receive actual share certificates although he may demand them at any time.

of spectacular success through speculative investment policies might sometimes outweigh considerations of safety.[8] Disclosure, particularly of investment objectives and of changes in policy, as required by the federal securities acts, is therefore important to investor protection.

Although the Commission makes no charge in this action with respect to the nature of respondents' investment policies, there are certain other practices currently engaged in by respondents which, under the securities laws, would clearly be prohibited. For example, under Section 27 (a) (1) of the Investment Company Act of 1940 registered investment companies issuing periodic payment plan certificates may charge no more than "9 per centum of the total payments to be made thereon." Both respondents charge a higher percentage. Under Section 27 (a) (2) of the Investment Company Act such registered investment companies may charge as sales load no more than "one-half of any of the first twelve monthly payments" received from investors. Both respond-

[8] Indeed, there could conceivably be pressure to have the dollar value of the unit go down. Although the life-expectancy tables presently used by the companies reflect anticipated increases in longevity, if, due to a dramatic medical discovery, these expectations should be exceeded, and the life span substantially increased, the company would be required to pay out the value of a greater number of units than originally estimated to the detriment of its stockholders. In order to reduce this unexpected expense, it would be advantageous to the company to reduce the dollar value of the units. This could be done by following an investment policy wholly contrary to the interest of the investors or even by failing to invest funds, since the annual management fee of 1.8% applies to cash as well as securities and an additional annual 3.5% deduction is made on all annuity units.

ents charge in excess of this percentage. The sales literature of each respondent, moreover, fails to conform in many respects to a Statement of Policy, adopted by the Commission,[9] which enumerates certain practices with respect to sales literature of investment companies that the Commission believes are "false and misleading." The Statement of Policy was adopted after compresensive studies of sales literature used in the sale of investment company shares and after opportunity to all persons to comment on drafts thereof, and was revised in the light of subsequent experience. It sets forth standards with respect to claims made on such matters as the rates of return on the investor's capital, the safety of his capital, the effect of government supervision on the management of the company, the benefits of dollar averaging and continuous investment, and the amount of the commissions charged. It prohibits the use of reprints from articles relating to the whole investment company industry and restricts the use of charts using information based on market indices. No attempt is made in the sales literature of respondents (R. 745–804) to conform to the standards set forth in the Statement of Policy. For example, each respondent refers in its sales literature to the value of an assumed investment over the past twenty years, based not upon the experience of the company but upon some stock market average of securities differing substantially from the company's current portfolio, and each respondent uses charts and graphs

[9] Investment Company Act Release No. 2621 (1955).

based upon these averages. These comparisons, without certain affirmative disclosures which respondents failed to make, as well as the charts and graphs based thereon, clearly contravene the Statement of Policy. VALIC, indeed, goes so far as to refer to its contracts as "INFLATION PROOF ANNUITIES" (R. 761)—a reference which would appear to be in gross violation of the full disclosure requirements of the Securities Act.

2. Both courts below, in reaching the result that the contracts here involved are not subject to regulation by the Securities and Exchange Commission, placed great emphasis on the fact that these contracts are regulated as insurance by local commissioners. This emphasis is misplaced, will result in much litigation and confusion, and will hamper effective enforcement by the Securities and Exchange Commission of the statutes subject to its administration.

The fact that local insurance commissions have regulated these companies and approved their contracts is not at all controlling. The statutory scheme is different from that involved in *Alleghany Corporation* v. *Breswick and Co.*, 353 U. S. 151, where, by specific provision of law, regulation by another body (the Interstate Commerce Commission) was the basis for an exemption. Here, on the contrary, both the Securities Act (15 U. S. C. 77r) and the Investment Company Act (15 U. S. C. 80a–49) provide that there may be concurrent regulation by the Securities and Exchange Commission and state commissions. For this purpose, it makes no difference whether individual states choose to exercise

supervision over particular securities through their insurance commissioners rather than their securities commissions. So long as the securities are not in fact insurance, the federal Commission is endowed with power under its legislation.

To be sure, regulation of the issuing company by an insurance commissioner is one condition precedent to the exemption of insurance or annuity contracts from the federal Commission's jurisdiction.[10] But it still must be found that insurance or annuity contracts are really involved, and the federal legislation does not refer that determination to the local authorities, but vests it in the federal courts. The state authority's determination that the contracts are in the nature of insurance or annuities is significant only so far as it helps in determining what they are in fact. Whatever evidentiary weight may be given to such a local determination, it cannot be conclusive on the federal

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[10] The exemption under Section 3 (a) (8) of the Securities Act requires first a determination that the instrument involved is an "insurance or endowment policy or annuity contract or optional annuity contract" and then, as an additional qualification, that it be "issued by a corporation subject to the supervision of the insurance commissioner * * *." Similarly, an insurance company exempted from the Investment Company Act must, under Section 2 (a) (17), be first determined to be a "company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies * * *," and additionally that the company be "subject to supervision by the insurance commissioner." The Investment Company Act specifically contemplates dual regulation by an insurance commissioner and the Securities and Exchange Commission in the situation where an investment company sells insurance policies. 15 U. S. C. 80a-24 (d).

agency. Similarly, the McCarran-Ferguson Act (App. B, *infra*, pp. 36–37) is not applicable because it does not purport to refer the question of what is "insurance" to the states; that Act comes into operation only after it has been decided that the "business of insurance" is involved.[11]

The issue here is simply one of determining the meaning intended by Congress in using the words "insurance" and "annuity" in the Securities and Investment Company Acts. We contend, for the reasons summarized above, that respondents' contracts are not such "insurance" or "annuities". We also suggest that in resolving this question the courts should give weight to the interpretation adopted by the Securities and Exchange Commission, the agency set up by Congress to administer the federal statutes.[12] The confusion and litigation that will flow from relying on the determinations of individual state commissioners is indicated by the results of a poll of thirty-seven states made in 1957 by the National Association of Securities Administrators to the effect that insurance commissioners are about evenly split on the

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[11] For this reason, the recent case of *Federal Trade Commission* v. *National Casualty Co.*, Oct. Term 1957, No. 435, decided June 30, 1958, has no present bearing. There, the question was the extent to which Congress ceded power to the states to regulate activities which patently and admittedly related to insurance. No issue was raised as to whether what was being regulated was in fact insurance.

[12] *S. E. C.* v. *Associated Gas & Electric Co.*, 99 F. 2d 795 (C. A. 2); cf. *United States* v. *Allen-Bradley Co.*, 352 U. S. 306; *N. L. R. B.* v. *Denver Building Council*, 341 U. S. 675; *United States* v. *American Trucking Associations, Inc.*, 310 U. S. 534.

question whether or not to approve the variable annuity for sale as insurance, while the securities commissioners are almost unanimous in their opinion that the variable annuity is a security.[13] In West Virginia, both the insurance commissioner and the securities commissioner are attempting to exercise their jurisdiction over the VALIC contracts.[14]

Ultimately, many of the determinations of state commissioners will probably be reviewed by state courts,[15] although to date there has been only one state court that has passed upon a contract substantially identical to the variable annuity.[16] The Supreme

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[13] 1 C. C. H. Blue Sky Rep. Para. 4711.

[14] See fn. 16, *infra*.

[15] See *State* v. *Towle*, 80 Me. 287, 14 Atl. 195, where the court said:

"*It does not seem probable that the legislature intended to commit to the care of the commissioner the business of illegal or illegitimate insurance companies.* It would be tolerating instead of condemning them. He has the power to issue and suspend licenses. But there must be cause for either act. * * * His business is to deal with such companies as can, when licensed, issue legal policies. *His act cannot confer legality upon companies doing illegal business.*" (Emphasis added.)

See also *Jordan* v. *Group Health Association*, 107 F. 2d 239 (C. A. D. C.).

[16] An "Estate Builder" contract, having certain features of the variable annuity contract and using insurance terminology was held to be an attempt to sell an investment as insurance in *Coastal States Life Insurance Company* v. *Kelly*, Court of Common Pleas, Richland County, So. Car., June 1955, unreported.

On July 21 and 22, 1958, there was a trial in West Virginia on a complaint for injunction instituted by the Securities Commissioner of that State to prevent VALIC from selling their contracts in violation of the securities laws of West Virginia. No decision has been rendered in that action as yet. *State of West Virginia* v. *Variable Annuity Life Insurance Co.*, Circuit Court of Kanawha County, W. Va., Docket No. 24, 449.

Court of Errors of Connecticut in *Spellacy* v. *The American Life Insurance Association,* 144 Conn. 346, 131 A. 2d 834, dealt with a "variable endowment" contract with a "variable annuity" option at the maturity date. That contract provides for investment by the company in a pool of equity securities. The purchaser's interest in the fund is represented by units which fluctuate in value in accordance with the investment experience of the fund, and upon maturity the purchaser may at his option become entitled to a periodic payment of units of fluctuating value during the remainder of his lifetime. The Connecticut court held that the contract was not an insurance or an annuity policy within the meaning of the term in the Connecticut General Statutes and as these terms are generally used and understood.

The court below, in holding that there was no jurisdiction in the Securities and Exchange Commission over variable annuities, was considering only the contract sold in the District of Columbia and approved for sale as insurance by its insurance commissioner. However, where state insurance commissioners have forbidden the sale of this contract as insurance or where there is internal conflict in the state, the court's opinion does not necessarily preclude regulation by this Commission. Thus, in the vast majority of states there is uncertainty as to the extent of the Commission's jurisdiction over variable annuities.[17]

[17] This result is hardly consistent with the nationwide protection of investors contemplated by Congress when the securities acts were adopted. See *e. g.*, Section 1 (a) (5) of the

Moreover, by reason of the McCarran-Ferguson Act this uncertainty may relate not only to the regulation by this Commission but also to the application to these companies of federal regulatory statutes not administered by this Commission, *e. g.*, the Federal Trade Commission Act.

3. Finally, in the area of investment company regulation there arises the question whether under the ruling of the court below companies now subject to regulation will be able to oust the Securities and Exchange Commission of currently exercised jurisdiction.

As noted above, the variable annuity during the pay-in period is virtually identical to the periodic purchase of mutual fund shares. It would be a simple matter for persons managing investment companies to add to a periodic accumulation plan an "annuity" provision which, being optional, would presumably elicit no objections from investors and thus enable the mutual fund to escape the jurisdiction of this Commission. Whether the investment companies would be required to comply with some type of insurance regulation, if they sought to change their operation to sell the variable annuity, is not clear and might vary from state to state, but it is clear that the change in the nature of their business would be minuscule.

Investment Company Act (15 U. S. C. 80a–1 (a) (5)) where it was declared that investment companies are affected with a national public interest because, among other reasons, the activities of such companies "extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors."

The size of the problem is demonstrated by the fact that open-end investment companies registered under the Investment Company Act of 1940, whose operations need only minor alterations in order to engage in the sale of variable annuity contracts, hold aggregate assets of nearly $10 billion and attract the capital of public investors at the rate of approximately $1 billion a year.

We have already indicated that, in view of the claimed ability of this contract to protect an investor against inflation, it is probable that this or some other type of investment contract payable over the period of a person's life will become a most important economic device. It is possible that a substantial proportion of the sales of annuities may be switched to the variable annuities. It is, therefore, of utmost importance to determine whether the contracts and those companies which sell the contracts are to be regulated by state insurance authority, by the Securities and Exchange Commission, or by both.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

J. LEE RANKIN,
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Securities and Exchange Commission.
AUGUST 1958.

APPENDIX A

United States Court of Appeals for the District of Columbia

No. 14,253

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and
EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES

No. 14,254

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., APPELLANT

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and
EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES

Appeals from the United States District Court for the District of Columbia

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Decided May 22, 1958

Before WILBUR K. MILLER and DANAHER, *Circuit Judges,* and MADDEN, *Judge,* United States Court of Claims.*

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*Sitting by designation pursuant to provisions of Sec. 291 (a), Title 28, U. S. Code.

MADDEN, *Judge:* Securities and Exchange Commission, (SEC), brought suit in the District Court seeking an injunction restraining Variable Annuity Life Insurance Company of America, Inc. (VALIC), from selling or offering for sale certain contracts or policies unless and until the contracts or policies were registered with SEC in accordance with section 5 of the Securities Act of 1933, 48 Stat. 74, 77, 15 U. S. C. § 77 (e), and unless VALIC complied with section 7 (a) of the Investment Company Act of 1940, 54 Stat. 789, 802, 15 U. S. C. § 80a–7 (a). On their own motions the National Association of Securities Dealers (NASD), and the Equity Annuity Life Insurance Company (EALIC), intervened on the sides of the plaintiff and the defendant, respectively.

The District Court dismissed the complaint, and the plaintiffs have appealed from that judgment. The original defendant and the intervening defendant sell the same kinds of contracts or policies. Those of VALIC will be discussed in this opinion.

The appellees contend that the contracts which they sell and which are the subject of this controversy are annuity policies and are therefore covered by the law relating to insurance, and not by the law relating to securities. They point to section 3 (a) (8) of the Securities Act of 1933, 15 U. S. C. § 77 (c) (a) (8) which says:

> SEC. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> * * * * *
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any

> agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;

They point to section 3 (c) (3) of the Investment Company Act of 1940, 15 U. S. C. § 80a–3 (c) (3), which says that an insurance company is not an investment company within the meaning of the Act, and to section 2 (a) (17) of that Act, 15 U. S. C. § 80a–2 (a) (17) which says:

> (a) When used in this title, unless the context otherwise requires—
>
> * * * * *
>
> (17) "Insurance company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

They point to the McCarran-Ferguson Insurance Regulation Act of March 9, 1945, 59 Stat. 33; 15 U. S. C. §§ 1011–1015, which says:

> * * * That the Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.
>
> SEC. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after January 1, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

* * * * *

SEC. 5. As used in this Act, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, and the District of Columbia.

Although VALIC sells what are undoubtedly life insurance contracts, they are tied in with its "annuity" contracts, and are a small part of its total business. If its "annuity" contracts are not annuity contracts within the meaning of the word annuity in the Securities Act of 1933, and within the contemplated business of insurance as that word is used in the Investment Company Act and the McCarran-Ferguson Act, the "annuity" label which VALIC places upon its contracts will not avail it.

We lay aside the life insurance feature of the policies, and discuss the annuity feature. In fact, as we understand it, if the applicant for an annuity policy is insurable, for life insurance purposes, he must take at least a five year term life insurance policy. That seems to us to be irrelevant to the question of the nature of the predominant annuity feature of the policy. We will therefore discuss a naked

deferred annuity policy such as would be issued by VALIC to one uninsurable for life insurance purposes.

The policy holder agrees to pay a fixed sum of money per year for each year until he reaches the age when his deferred annuity will begin to pay out. A considerable part of what he pays for the first year, and a smaller part of what he pays thereafter are taken by the company for selling and administrative expense and profit. The rest is invested, at the discretion of the company, in securities which, it is hoped, will produce an income or show a capital gain or both. The policy holder is given periodic statements showing what the company has bought with what he and the other policy holders have paid in. These are statements of his "accumulation units." If, for example, the common stocks which the company held at the time the policy holder paid his annual premium were cheap, he would acquire, for the dollars he paid in, a larger number of "accumulation units", since the price or value of the "accumulation units" would be determined by dividing the value of the company's holdings by the number of the units. If thereafter the value of the company's holdings increased, the policy holder would still have the same number of units, but the value of each unit would be higher. If the value of the holdings decreased, the result would, of course, be the opposite.

Throughout the paying-in period, the value of the policy holders' accumulations would fluctuate with the price of the securities in which the company invested its funds. The policy holder would hope that the long run trend of the prices would be upward. If so, "accumulation units" which he acquired in the early years for $1.00 might be worth $1.50 or $2.00 by the time his deferred annuity came due.

When the time comes for the company to begin to pay the deferred annuity, the policy holder acquires no more "accumulation units" since he will pay no more premiums. The number of "accumulation units" which he has acquired during the years of his payment of premiums will be multiplied by the then value of an accumulation unit, and that dollar amount will be the amount upon which his annuity will be computed. Using the mortality table appropriate to his age and sex, and assuming that 3½ percent interest can be earned upon the funds of the company until they are paid out, the dollar amount, per month, of his annuity is determined, and he is paid that amount for one month. The payments thereafter are determined according to the success of the company with its investments, and may be smaller or larger than the first month's payment. If the value of the "accumulation units", the number of which was fixed when the premium payments stopped, increases, the annuity payments will increase at that time to what they would have been if the units had had that value at the time the first month's annuity had been computed.

The arrangement is, of course, novel. It has been invented in an attempt to obviate the lack of reality of the traditional life insurance and annuity policy in relation to the value of the dollar. Annuity policies bought to provide a living in his latter years for the policy-holder annuitant, and life insurance policies bought to provide for the families of deceased policy holders have proved inadequate because of the decline of the value of the dollar in terms of purchasing power. Persons who have paid for life insurance or annuities have wished that they had bought, instead, tangible things or equities which would have, or might have, kept pace with the inflation of prices. There

was room and need for experimentation in an effort to meet this serious problem. The contracts or "policies" offered by VALIC are an experiment in that direction. The question in this litigation is whether these contracts are "insurance" contracts, within the meaning of the statutes quoted above.

The Superintendent of Insurance of the District of Columbia, after due inquiry, issued to VALIC a certificate of authority "to transact within the District of Columbia the business of Life Insurance and Variable Annuities." Insurance Commissioners of three other States have issued similar licenses. The opinion of these officials, charged with the task of careful supervision of the business of insurance to protect the public from imposition, that the business of VALIC is the business of insurance, is important.

Elements of similarity between the "variable annuity" here in question and the traditional annuity may be noted. Both provide that the policy holder may elect at what time between certain stated ages, such as 50 and 70, the annuity payments are to begin. Both provide that the policy holder may cash in the value of his annuity before annuity payments begin. Both provide a loan value for the annuity contract. Both provide for the payment to beneficiaries in case of the death of the annuitant before annuity payments begin. Both provide that if the policy holder ceases paying premiums, a reduced annuity is nevertheless acquired for the payments he has made. Both provide options whereby payments may continue to another beneficiary after the death of the principal annuitant, and other options. Both have provisions making the annuity payments exempt from the claims of creditors.

It is apparent that the VALIC contract bears many resemblances to a conventional annuity policy. The

appellants say that these resemblances are superficial; that the identifying quality of insurance is risk-shifting, and that in the VALIC contracts the policy holder bears his own risk, the risk that the company's investments of his premiums will increase or decrease in value. But perhaps the most important risk that the purchaser desires to shift when he buys an annuity is the risk that he will live longer than his funds will last. If everyone died on the day set for him by the mortality tables, there would be no point in paying an insurance company for doling out one's funds. A savings account, or Government or municipal or good corporate bonds, or a simple trust would do as well. VALIC, by the fact of issuing an annuity policy, does assume the risk of when the annuitant will die. If it does not bear the risk itself, it provides the machinery whereby the risk is shifted from the individual to the group of policy holders.

The appellants urge that VALIC policy holders, like investors in investment companies, may lose their savings and ultimately fail to receive the protection which they hoped to buy when they paid their premiums. That fact seems to us to be inherent in the nature of this experiment in annuity contracts. Holders of traditional annuity policies in Germany lost all their protection in the inflation of the twenties, and in France nearly all their protection in the post-war inflation. We have already adverted to the situation in this country. Experience in England has been similar.

The statutes which we have quoted above show an unmistakable determination on the part of Congress to leave the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it. The appellants say that, by definition, the business of the appellees is not insurance. We find no such definition. The

definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance. The VALIC contracts have many qualities of the traditional business of insurance. They depart from the tradition only in their attempt to solve a problem badly in need of solution. Unless we confine insurance, by definition, to what has actually been done in the past under the name of insurance, and invent a new and distinctive name for this new business which so greatly resembles insurance, we should not contradict the insurance commissioners. The new business will need the expert and watchful supervision of these experts in insurance. We think the statutes lodge the responsibility with them.

The judgment of the District Court is

Affirmed.

Judgment

United States Court of Appeals for the District of Columbia Circuit

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No. 14,253 April Term, 1958.

SECURITIES AND EXCHANGE COMMISSION, APPELLANT,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and

EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES.

No. 14,254 April Term, 1958.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., APPELLANT,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, INC., and

EQUITY ANNUITY LIFE INSURANCE COMPANY, APPELLEES.

Appeals from the United States District Court for the District of Columbia

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Before: Wilbur K. Miller and Danaher, Circuit Judges, and Madden, Judge, United States Court of Claims.

These cases came on to be heard on the record from the United States District Court for the District of Columbia, and were argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the judgment of the said District Court appealed from in these cases be, and it is hereby, affirmed.

It is further ordered by the Court that appellees herein recover from appellant National Association of Securities Dealers, Inc., one-half the cost of printing their briefs in these cases, and have execution therefor.

Dated: May 22, 1958.

Per Judge MADDEN.

APPENDIX B

STATUTES INVOLVED

Section 2 (1) of the Securities Act of 1933 (48 Stat. 74, as amended; 15 U. S. C. 77b (1)) provides:

> SEC. 2. When used in this title, unless the context otherwise requires—
>
> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 3 (a) (8) of the Securities Act of 1933 (48 Stat. 76; 15 U. S. C. 77c (a) (8) provides:

> SEC. 3. (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> * * * * *
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;

Section 5 of the Securities Act of 1933 (48 Stat. 77, as amended; 15 U. S. C., Supp. II, 77e) provides:

> SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.
>
> (b) It shall be unlawful for any person, directly or indirectly—
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or
>
> (2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.
>
> (c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the

effective date of the registration statement) any public proceeding or examination under section 8.

Section 3 (a) (1) and 3 (a) (3) of the Investment Company Act of 1940 (54 Stat. 797; 15 U. S. C. 80a–3 (a) (1) and (3) provide:

SEC. 3. (a) When used in this title, "investment company" means any issuer which—

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

* * * * *

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

Section 3 (c) (3) of the Investment Company Act (54 Stat. 798; 15 U. S. C. 80a–3 (c) (3)) provides:

(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

* * * * *

(3) Any bank or insurance company; * * *

An insurance company is defined in Section 2 (a) (17) of the Investment Company Act (54 Stat. 790, 793; 15 U. S. C. 80a–2 (a) (17) as—

(a) When used in this title, unless the context otherwise requires—

* * * * *

(17) "Insurance company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the

reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

Section 7 (a) of the Investment Company Act of 1940 (54 Stat. 802; 15 U. S. C. Sec. 80a–7 (a)) provides:

SEC. 7. (a) No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 8, shall directly or indirectly—

(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person;

(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2);

(4) engage in any business in interstate commerce; or

(5) control any company which is engaged in any business in interstate commerce.

Section 24 (d) of the Investment Company Act (54 Stat. 826; 15 U. S. C. 80a–24 (d)) provides:

> The exemption provided by paragraph (8) of section 3 (a) of the Securities Act of 1933 shall not apply to any security of which an investment company is the issuer. The exemption provided by paragraph (11) of said section 3 (a) shall not apply to any security of which a registered investment company is the issuer, except a security sold or disposed of by the issuer or bona fide offered to the public prior to the effective date of this title, and with respect to a security so sold, disposed of, or offered, shall not apply to any new offering thereof on or after the effective date of this title.

Sections 27 (a) (1) and 27 (a) (2) of the Investment Company Act of 1940 (54 Stat. 797; 15 U. S. C. 80a–27 (a) (1) and 15 U. S. C. 80a–27 (a) (2)) provide:

> SEC. 27. (a) It shall be unlawful for any registered investment company issuing periodic payment plan certificates, or for any depositor of or underwriter for such company, to sell any such certificate if—
>
> (1) the sales load on such certificate exceeds 9 per centum of the total payments to be made thereon;
>
> (2) more than one-half of any of the first twelve monthly payments thereon, or their equivalent, is deducted for sales load;

The McCarran-Ferguson Insurance Regulation Act (59 Stat. 33, as amended; 15 U. S. C. 1011–1015) provides in pertinent part:

> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the Congress hereby declares that the continued regulation and taxation by the several States of the business of

insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

SEC. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

* * * * *

SEC. 5. As used in this Act, the term "State" includes the several States, Alaska, Hawaii, Puerto Rico, Guam, and the District of Columbia.

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